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## Securitization Outline

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enhancement  
by risk distribution  
rather than by equity

## Securitization

I. Introduction: a definition; securitization is a new financing arrangement or institution that is changing traditional financial institutions. *not a definition*

II. The evolution and explanation of the existence of securitization.

Commonwealth Paper

A. Government guarantees: Ginnie Maes, Freddie Macs, and Fannie Maes. Securitization starts in the public sector.

1. Rationale behind the advent of these programs.

a. pressure from Savings and Loans

b. economic conditions

c. provide more funds for mortgages (give people what they prefer-- fixed rate mortgages).

2. Transitional Gains Gap

3. Did Government create the market or just innovate faster than the private market due to cost conditions, economies of scale or some efficiency.

B. Private sector issues of securities backed by pools of single family mortgages (passthroughs, paythroughs and mortgage backed bonds)

1. Why did it take so long before the private sector started securitizing all on its own (more than 10 years)

Separate Risk - #.

Technology:

- a) communication
- b) computation
- c) information processing

Technology allows for substitution - survey for - based on

- a. needed an established market.
- b. needed the appropriate technology
- c. the impact of regulations and regulatory changed.
- d. the connections of globalization

2. Prepayment risk and development of CMOs.

c. New assets being securitized (in chronological order)

- 1. car loans
- 2. receivables
- 3. leases
- 4. credit card accounts
- 5. commercial mortgages

D. Low-Spread as a byproduct for business lending

III. Securitization has changed the number of players and methods involved in financial transactions.

A. Mortgages

- 1. The change from 3 players involved (lender, financial intermediary who issues mortgage and mortgage holder) to 7 players involved (the original three plus the investment banker or underwriter, the trustee, the guarantor, and the ultimate investor.)

a. What are the implications of this?

up to 5 or 6 different sets of institutions in market

with relevant to what

function in financing

basic

- a) paper creation
- b) enhancement
- c) funding

2. securitization

- a) paper creation / multiple pieces of paper
- b) underwriting / complex of liabilities
- c) funding
- d) insurance (concept)

a) primary owner

b) secondary owner

c) mortgagee

b. Mortgage holder probably won't know the difference.

B. Businesses have option to bypass traditional funding sources and deal directly with the securities market.

1. If receivables have better credit rating than company, then company has possibility to obtain funds at a lower cost through bundling their receivables and selling them as securities.

a. securitization opens up additional funding avenues; it also can lessen entry barriers.

b. if securitization is used will there be any impact on the company's stock prices; is the company more subject to failure.

2. Builders and Real Estate Developers

a. more homes are built within the guidelines that satisfy FHA regulations so the mortgages can be used for Ginnie Maes and Freddie Macs.

b. new funding sources are open: can securitize leases from office building to finance construction or refinance existing office buildings and then securitize the mortgages.

IV. Why does securitization exist? In other words why is it desirable?

A. In Coase's zero transaction cost world, securitization would have no purpose because those who value mortgages most would issue them; however in the real world those who specialize in mortgages, S & L's, have short term liabilities and long term assets (a

What language is this

Company in  
credit but  
collects paper for  
# companies

Don't  
S.M.C. n  
Heller x  
try to  
form the securitized  
rather than  
a company with  
receivables

need to destroy  
the Builder as individual  
selling "Mortgage Bank"  
how securitized  
"baskets" assets

Coase's exist  
there is it  
desirable?  
Can come  
expect it to  
good!!

really:  
p26

mismatching problem). Institutional investors who need long term assets would value having the mortgages on their portfolio. Securitization allows those who value the assets the most to own them even if they lack the resources to originate them.

## V. Lack of Regulations; the existence of trouble spots

A. Since securitization involves so many different types of financial institutions, there is not on regulatory body over the whole process.

B. Possible and inherent dangers. *Stealing*

1. Epic : an example of securitization gone awry.

## VI. The impact on financial institutions; What we can expect to see in the future.

A. Likely regulatory changes could encourage securitization and thus further the specialization of financial institutions.

1. increasing the capital requirements to 7%

2. FSLIC is in big trouble so possible merging with FDIC, then all commercial banks would also share in the costs of supporting the S & L's.

Costs:

costs 1 down  
business  
through  
chance > through  
new channel

exposure to losses  
> through  
new channels than  
existing.

risk adjusted value